Pimco Loss Is Prudential Fund's Gain as Investors Add $7 Billion

Photographer: Emile Wamsteker/Bloomberg

by Charles Stein

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- Prudential Total Return triples assest over past year
- Fund outperforms by buying banks bonds, avoiding energy

The Prudential Total Return Bond Fund has outperformed most of its peers, including the flagship fund at Pimco, over three, five and 10 years. Investors have finally noticed.

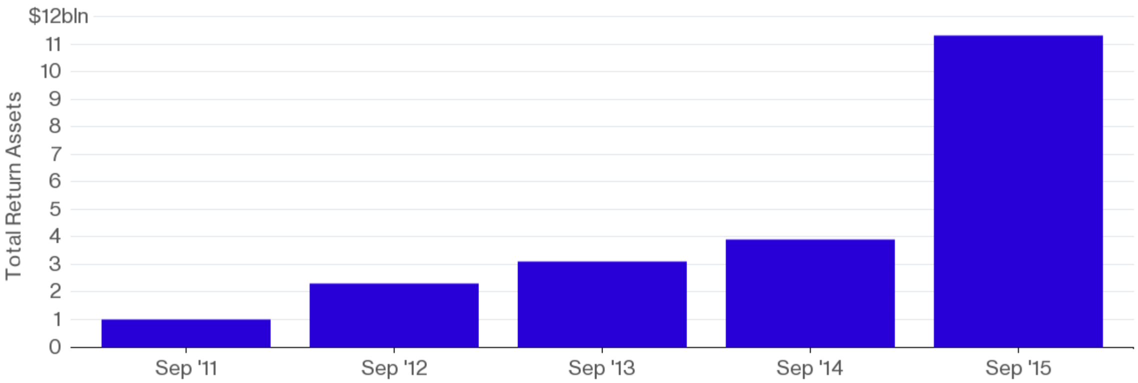
The fund's assets have almost tripled in the past year to $11.6 billion, according to data compiled by Bloomberg. Some of the more than $7 billion in new deposits came from investors fleeing Pacific Investment Management Co.'s Total Return Fund following the sudden departure of Bill Gross.

The Prudential fund managers have provided a steady hand -- two of them have worked together on it for six years. They returned 4.7 percent over the past five years to beat 90 percent of rivals. Their results have also been more consistent than Pimco’s, topping more than 60 percent of peers in 10 of the last 11 years.

“People looking for other bond funds saw our historical performance, our consistency and the fact that we have a stable team of decision makers,” said Michael Collins, who has co-managed the fund at Prudential Investment Management Inc. since 2009.

Prudential Fund Triples Assets

The firm's Total Return Fund has lured more than $7 billion in assets in the past year as investors fled Pimco following Bill Gross's exit.



Source: Bloomberg

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Investors pulled about $400 billion from Pimco in the year after Gross left the firm in September 2014 amid a leadership dispute and joined Janus Capital Group. The biggest winners from Pimco’s loss were TCW Group Inc., Vanguard Group, DoubleLine Capital, Dodge & Cox Inc. and BlackRock Inc., each with a fund that attracted more than $10 billion through September 2015.

Mayflower Advisors, which oversees $2 billion in Boston, screened a group of bond funds after Gross’ departure, looking for a substitute for Pimco. It put some of the money in the Prudential fund because of its stability, solid credit quality and low volatility.

Prudential Wins

“When money was in motion, it was a thoughtful alternative,” said Lawrence Glazer, a managing partner at Mayflower.

Kashif Ahmed, who founded American Private Wealth in Woburn, Massachusetts, chose the Prudential fund partly because the managers also run money for the insurer Prudential Financial Inc., PIM's parent. Prudential Fixed Income, part of the insurance company's asset management business, oversees $550 billion in bonds.

"Insurance companies have to buy fixed-income," said Ahmed. "It's in their DNA."

The Prudential Total Return fund has outperformed with a series of timely bets on sectors of the bond market and with a view, articulated in 2013, that interest rates would stay low for an extended period.

Bank Bonds

The managers this year have favored bank bonds. The fund has 11 percent of its money in the bonds, more than twice their allocation in the benchmark Barclay's U.S. Aggregate Bond Index.

"We felt that given the regulatory environment, banks were going to de-risk and be more like utilities," said Collins, 52. "That's a a plus for debt holders."

At the same time the fund limited its exposure to industrial bonds, which are vulnerable to falling commodity prices and weakening exports. Bank bonds have gained 2.6 percent this year, compared with 0.6 for industrial bonds, according to Bank of America Merrill Lynch indexes.

The fund has roughly one-third of its money in asset-backed securities, a mix of commercial mortgages and collateralized loan obligations, or packages of loans. Both products offer returns that are higher than comparably rated corporate bonds, and come with less risk, said Robert Tipp, 52, a manager on the fund since 2002.

Low Rates

A Bank of America Merrill Lynch global collateralized index gained 1.9 percent this year.

In September 2013, with the yield on the 10-year Treasury note at about 3 percent, Tipp wrote a paper called "The Low Ranger," in which he predicted that yields would stay below 3 percent over the near and medium-term.

He reasoned that in the aftermath of the financial crisis, consumers would need to cut their level of debt, leading to sub-par growth and low inflation for the foreseeable future. The yield on 10-year Treasuries has averaged 2.3 percent since the end of 2013, according to data compiled by Bloomberg.

“A little bit of bad news is not bad for bonds,” Collins said.

Bullish on Bonds

That forecast led managers in 2014 to increase the fund’s duration, or sensitivity to changes in interest rates, helping it outperform 94 percent of peers.

Prudential’s analysts this year also steered the fund away from investments in high-yield commodity and energy bonds. The latter lost 9.6 percent in 2015, Bank of America Merrill Lynch indexes show.

“Our analysts knew there was going to be a bloodbath,” Collins said.

The fund’s managers, who include Richard Piccirillo and Gregory Peters, are bullish on bonds. They expect sluggish global growth, which translates into low inflation, low interest rates and easy monetary policy from key central banks. The U.S. will do better, they argue, which means that global investors will find U.S. fixed-income attractive, lifting prices on many of their investments.

“Bonds will surprise people on the upside,” Tipp said. “They will continue to be a decent source of income.”

(An earlier version of this story corrected Richard Piccirillo’s first name.)

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